No. 552

In the Supreme Court of the United States

October Term, 1942

Interstate Transit Lines, petitioner

v.

Guy T. Helvering, Commissioner of Internal Revenue

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

INDEX

CITATIONS

500419—42

In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 552

INTERSTATE TRANSIT LINES, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 16–21) is reported at 44 B. T. A. 957. The opinion of the Circuit Court of Appeals (R. 86–95) is reported at 130 F. (2d) 136.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 31, 1942 (R. 95–96). Petition for rehearing was denied September 8, 1942 (R. 103). Petition for a writ of certiorari was filed November 28, 1942. The jurisdiction of this

Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether a deficit incurred by a wholly owned subsidiary of the taxpayer and paid by taxpayer pursuant to contract was deductible from gross income as an ordinary and necessary expense in carrying on the business of the taxpayer, under Section 23 (a) of the Revenue Act of 1936.

STATUTE INVOLVED

Revenue Act of 1936, c. 690, 49 Stat. 1648:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME. In computing net income there shall be allowed as deductions:
>
> (a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *.

STATEMENT

The taxpayer is a Nebraska corporation engaged in the operation of interstate bus transportation lines between Chicago, Illinois, and Los Angeles, California, handling intrastate business in Iowa, Nebraska, Kansas, Colorado, Wyoming, Utah and Nevada (R. 16–17). It was unable to handle intrastate business in California because the Railroad Commission of that State had refused to grant to foreign corporations authority for intrastate operation (R. 17). In 1930, the taxpayer, in

order to increase its income by carrying California intrastate traffic, which it could do without substantial increase in its facilities or expenses, organized a subsidiary corporation, Union Pacific Stages of California, under the laws of California. The subsidiary was authorized to conduct intrastate operations in California. (R. 17.)

The taxpayer furnished all the capital of the subsidiary and held all its capital stock. The two corporations entered into contracts which provided that the subsidiary would operate on such routes and schedules as would most benefit the taxpayer, as directed by the taxpayer, that the taxpayer would assume and reimburse the subsidiary for any operating deficits incurred by it, and that the subsidiary would pay to the taxpayer any profit resulting from its operations. It was further agreed that the subsidiary, in addition to operating its intrastate business, would also conduct the interstate operations of the taxpayer in California. (R. 17.)

The taxpayer and the subsidiary had the same officers and directors. The subsidiary had its own accounting records and corporate books which were kept in the offices of the taxpayer. The subsidiary had no bank account and taxpayer collected its revenues and paid its bills. The revenues and expenses of both corporations were apportioned between them on the basis of passenger and traffic miles. (R. 18.)

For the calendar year 1936, the subsidiary incurred an operating deficit of $28,100.66 which was charged to the taxpayer as of December 31, 1936. A corresponding credit was entered upon the subsidiary's books on the same date. On December 31, 1936, before these entries were made, the subsidiary was indebted to the taxpayer in a net amount of about $34,000, so that the entries made with respect to the alleged deficit of $28,100.66 merely reduced the net indebtedness of the subsidiary to the taxpayer by the amount of the deficit and left the subsidiary still indebted to the taxpayer in an amount exceeding $5,000. For the years 1932 and 1933, affiliated returns were filed by the taxpayer and the subsidiary. (R. 19.)

Several years after 1936, the taxpayer was able to obtain authority to conduct intrastate business in California and the subsidiary was therefore dissolved and its assets transferred to the taxpayer (R. 19).

The taxpayer sought to deduct the 1936 deficit of $28,100.66 of its subsidiary as an ordinary and necessary expense of its own business. The Commissioner disallowed the deduction and assessed the deficiency under review. (R. 19.) The Board sustained the Commissioner's determination (R. 19–21), and the court below affirmed (R. 95).

ARGUMENT

The court below held that the deficit of the taxpayer's subsidiary was not deductible by the tax-

payer as an ordinary and necessary business expense and rejected the taxpayer's contention that the separate entity of the subsidiary corportation should be here disregarded. The decision was correct; it turns upon its own facts; and it presents no conflict.

1. The deduction here involved was not an expense of the taxpayer's business. The taxpayer was engaged in the business of *interstate* transportation. It lacked legal capacity, under the laws as then construed, to engage in *intrastate* transportation within the State of California. To permit its facilities to be used in intrastate transportation in California the taxpayer formed the subsidiary corporation which secured the necessary authority to engage in the intrastate transportation in California from which the taxpayer was barred.

Taxpayer's payment of the deficit incurred by its subsidiary was not, therefore, a business expense of the taxpayer. Deductions for losses are normally available only to the taxpayer sustaining them, and identity of economic interests does not vary the rule. *New Colonial Co.* v. *Helvering,* 292 U. S. 435, 440. Nor is it important that the taxpayer was bound by contract to pay the item in question. *Deputy* v. *du Pont,* 308 U. S. 488, 498.

The taxpayer urges (Pet. 11) that the decision of the court below conflicts with *Wiggin* v. *Commissioner,* 46 F. (2d) 743 (C. C. A. 1). But that case presented facts markedly different from

those involved here. In the *Wiggin* case, the principal stockholder of a depressed company entered into a contract with it to take over the business and run it for a specified number of years, agreeing to pay all costs on the understanding that he was to retain any profits. The court construed the contract to attribute the losses to the contracting individual and accordingly allowed him the corresponding deduction. It further observed (p. 745) that if there were doubt whether the business taken over by the taxpayer was the taxpayer's business, the losses were in any event deductible under section 214 (a) (5), as "incurred in any transaction entered into for profit."

Here, as we have noted, the business of the subsidiary was not only not the taxpayer's business but it was business which the taxpayer could not transact.

Other cases urged by petitioner as in conflict similarly involved different situations. In *New York, C. & S. L. R. R. Co.* v. *Helvering,* 71 F. (2d) 956 (App. D. C.), the payments of taxpayer were made by it as a part of its own business as operating lessee. *Western Maryland Ry. Co.* v. *Commissioner,* 33 F. (2d) 695 (C. C. A. 4),[1] and *New York Cent. R. Co.* v. *Commissioner,* 79 F. (2d) 247 (C. C. A. 2), certiorari denied, 296 U. S.

[1] Cf. *May Oil Burner Corp.* v. *Commissioner*, 71 F. (2d) 644 (C. C. A. 4), in which the same court recognized the rule applied by the court below in this case.

653, involved the right of a successor corporation to deduct the annual amortization of discount of bonds issued by the predecessor corporation. Relief was there granted upon a theory inapplicable to the instant case, and indeed, in the *New York Cent. R. Co.* case, the court expressly distinguished such a case from those disallowing the deduction by one corporation of another corporation's loss.

2. The taxpayer further contends (Pet. 14–19) that the refusal of the court below to disregard the separate entity of the subsidiary corporation is in conflict with a number of other decisions. But plainly it cannot be said that there is a conflict simply because in some cases the corporate entity is disregarded, while in others it is not. The question when corporate entities may be disregarded must necessarily hinge upon the peculiar facts and issues involved in each case.[2]

Thus *Inland Development Co.* v. *Commissioner*, 120 F. (2d) 986 (C. C. A. 10), involved the application of the personal holding company statute and turned upon its own unique facts. Moreover, the case involved an assessment of income rather than a deduction and the court concluded that the taxpayer did not fall within the scope of the statute. In *North Jersey Title Ins. Co.* v. *Commissioner*, 84 F. (2d) 898 (C. C. A. 3) where the

---

[2] Compare *United States* v. *Brager Building & Land Corp.*, 124 F. (2d) 349 (C. C. A. 4), with *American Package Corp.* v. *Commissioner*, 125 F. (2d) 413 (C. C. A. 4).

taxpayer was permitted to disregard the corporate entity of the subsidiary, the subsidiary was organized merely to hold title to property of a fraudulent debtor in protecting the existing business of the taxpayer. *United States* v. *Brager Building & Land Corp.,* 124 F. (2d) 349 (C. C. A. 4) involved a like situation. See *American Package Corp.* v. *Commissioner,* 125 F. (2d) 413 (C. C. A. 4).[3]

The taxpayer relies generally (Pet. 16) upon *Southern Pacific Co.* v. *Lowe,* 247 U. S. 330, and *Gulf Oil Corp.* v. *Lewellyn,* 248 U. S. 71. But as this Court stated in *Burnet* v. *Commonwealth Imp. Co.,* 287 U. S. 415, 420, those cases presented peculiar situations and cannot be regarded as establishing a general rule authorizing disregard ot corporate entity in respect of taxation. In *Higgins* v. *Smith,* 308 U. S. 473, 477, construing its own decision in the *Commonwealth Imp. Co.* case, *supra,* this Court said that, while a taxpayer is free to adopt such organization for his affairs as he may choose, if he elects to do some business as a corporation "he must accept the tax disadvantage." Cf. *Watson* v. *Commissioner,* 124 F. (2d) 437 (C. C. A. 2), *Texas-Empire Pipe Line Co.* v. *Commissioner,* 127 F. (2d) 220 (C. C. A. 10), and

[3] *Munson S. S. Line* v. *Commissioner,* 77 F. (2d) 849 (C. C. A. 2d), is a unique case where the corporate entity was disregarded to give effect to the intent of Congress as expressed in special legislation enacted to encourage merchant marine operators.

Commissioner v. *Moline Properties, Inc.* (C. C. A. 5th), decided November 7, 1942, not yet officially reported but may be found in 1942 C. C. H., Vol. 4, paragraph 9728; cf. *Gray* v. *Powell,* 314 U. S. 402, 414.

CONCLUSION

The court below correctly applied principles enunciated by this Court. There is no conflict of decisions. The petition for writ of certiorari should be denied.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.
SAMUEL O. CLARK, JR.,
Assistant Attorney General.
SEWALL KEY,
JOSEPH M. JONES,
Special Assistants to the Attorney General.

DECEMBER 1942.

U. S. GOVERNMENT PRINTING OFFICE: 1942